$50.00 ANNUALLY
40 Letters Per Year

# DOW THEORY LETTERS

*"The Market as Interpreted under the Dow Theory"*

RICHARD RUSSELL
P. O. Box 15196
San Diego 15, California

Registered with the Securities and Exchange Commission

All Rights Reserved



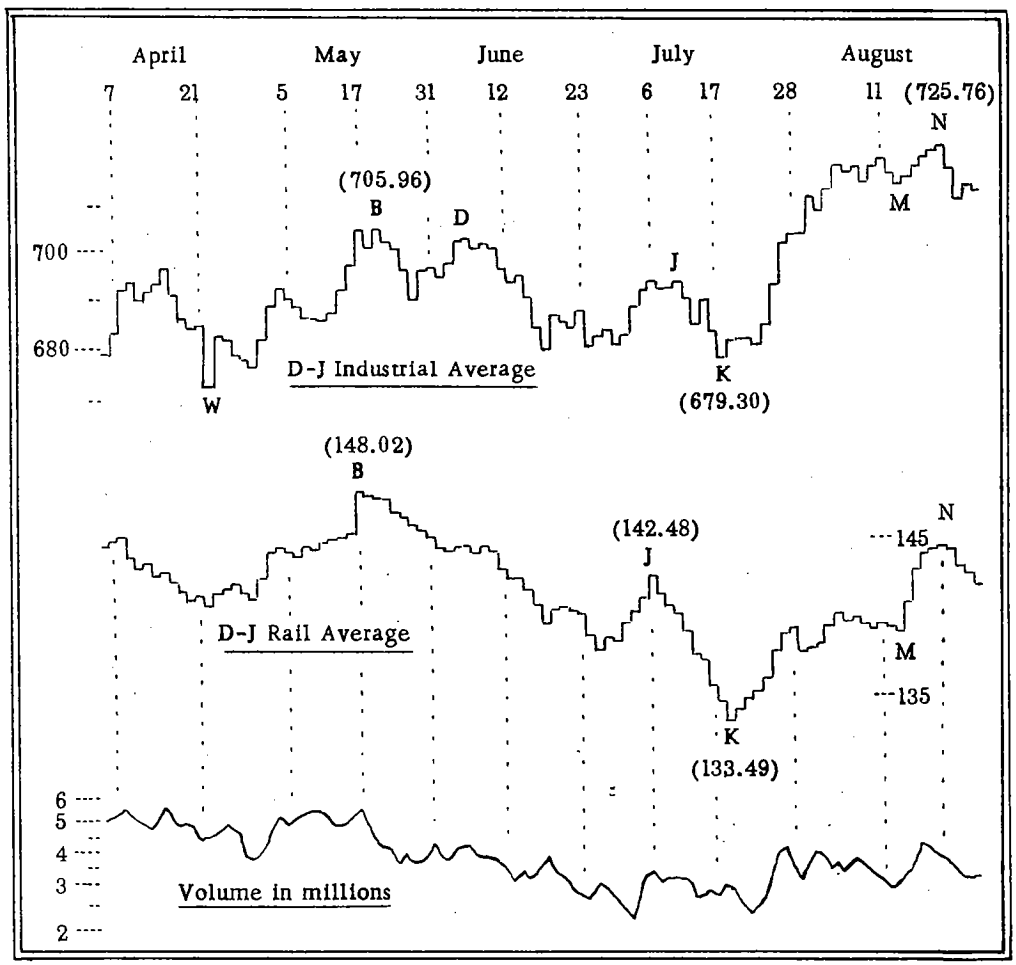
THE MARKET Letter 153 drew attention to the violence of the July 18 to August 22 rally (K to N on chart). That Letter further stated: "It would be normal to witness a one-third to two-thirds correction of the recent....advance. Such a correction, (if it is to be a healthy one) might see Industrials holding at about the 708 to 694 level with volume contracting sharply on the decline".

The market has performed about as expected following the August 22 peak at N (725.76). In the space of a few trading days, Industrials have dropped 11 points, thus erasing 24% of the 46 point K to N advance. Over the same period Rails have given up 17% of their K-N advance.

Volume has contracted steadily on the decline, suggesting that (so far) there has been no real liquidating pressure. Furthermore, it is significant that although the decline has taken Industrials below their preceding minor decline low at M (716.18), Rails have held above their corresponding M point (139.44). Under Dow Theory, a penetration of one Average unconfirmed by the other has no forecasting value.

It is also interesting to observe that over the last few weeks the odd-lot public has turned bearish, and odd-lot totals have swung heavily to the sell side.

Severe reactions seldom develop in the face of contracting volume and heavy odd-lot selling. If (1) odd-lot selling continues, (2) volume remains low, and (3) Rails continue to hold above point M, the chances are that there will be another attack on the N highs. If such a rally fails to take both Averages over N, and if the two Averages then turn down again on increasing volume, I would be more inclined to take a short-term bearish view than I am at present.




The market story is not entirely constructive, however. As noted in recent Letters, the advance-decline ratio (A-D ratio), which represents the trend of all the stocks on the board, has not followed the Industrial Average to new highs. On August 22, with the Industrial Average at an all-time high of 725.76, the A-D ratio barely surpassed its minor peak of July 6 (see Letter 152). On the same day (August 22), the 5-day average of new highs registered 66, a figure well below those seen in March and April. In other words, the stocks in the Industrial Average continue to outperform the general market. When this condition prevails, we

know that one of two courses must be taken: (1) either the general market will follow the lead of the Industrial Average and move into higher ground, or (2) the Industrial Average will decline in harmony with the general market.

CONCLUSION: Under Dow Theory, a trend is taken to remain in force until proved otherwise. The primary trend was last confirmed as bullish. The secondary trend was last confirmed as bullish when Rails confirmed Industrials by bettering point J (142.48). The Industrial Average has reversed to the downside over the last week. If Rails now confirm by violating point M (139.44), the secondary trend will be considered bearish.

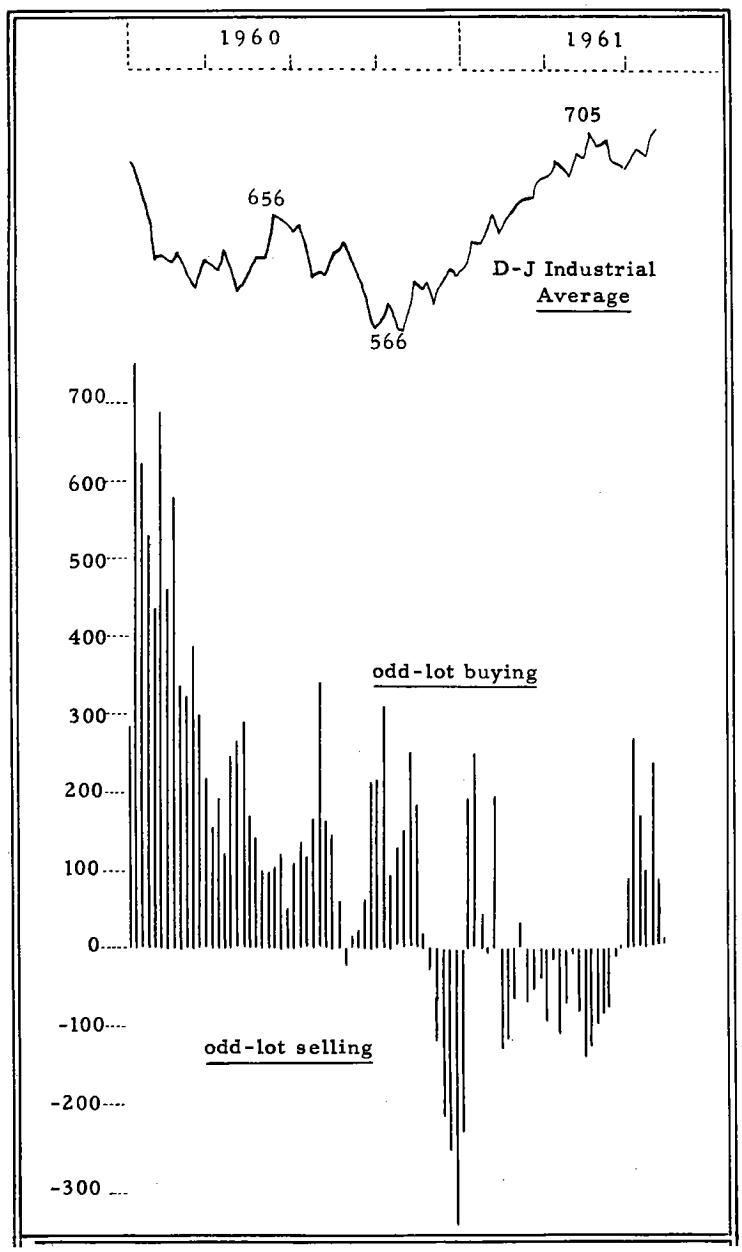
ODD-LOTS The odd-lot (under 100 share) buyer is generally considered to be representitive of the public. Although the public can be correct in its buying or selling for considerable periods of time, the history of the odd-lot transactions suggests that the public (odd-lotters) are most apt to be wrong at important market turns.

In my own experience, I have found that the weekly oficial S. E. C. statistics on odd-lot transactions (published every Tuesday in the Wall Street Journal) can be extremely informative. The weekly figures, in fact, may often provide a more graphic picture of overall odd-lot activity than the daily odd-lot ratios.

The accompanying chart (taken from S. E. C. figures) shows the weekly balance of odd-lot purchases over sales (0 to 700) or sales over purchases (0 to -300). As a rule, it takes at least three or four weeks (often many months) of heavy distribution by informed market elements before a major top can be built. Such distribution usually occurs under the most ideal conditions, namely -- bullish newspaper headlines and accompanying enthusiastic public (odd-lot) buying.

Note (on the chart) the extremely heavy odd-lot buying balances which occurred during early 1960. At that time the settlement of the steel strike caused the public to buy heavily. Informed investors (sensing trouble ahead) sold the public all the stock it wanted, and the market turned down and continued down for the next ten months.

Towards late 1960 the weekly odd-lot balances switched to the selling side, and they remained on the selling side until May, 1961. During this time the market worked progressively higher as "stronger money" continued to accumulate stocks. Towards the end of June, 1961, the public turned mildly bullish again, and the chart shows the small area of odd-lot buying. More recently (beginning in early August) the odd-lotters have switched to selling. Why the public has turned bearish lately we do not know -- perhaps it is the influence of the Berlin crisis, perhaps it is the very height of the Industrial Average itself.




One thing is brought out clearly by the weekly odd-lot chart, however, and that is that the great public enthusiasm of early 1960 has not been matched since. The question might then be asked: "Has there been enough odd-lot buying over the last few months to suggest that a major area of distribution (a "top") has been formed? My personal guess is that there has not, but I strongly suggest that readers review the section in Letter 153 entitled "Checking the Primary Trend".

BARRON'S CONFIDENCE INDEX and THE BOND AVERAGES. The confidence Index (C.I.) was not particularly helpful during the market rise which began in October, 1960. Despite the recent series of all-time highs on the Industrial Average, the C.I. never bettered its previous 1959 high of 89.7. For that reason the C.I. has lost a great deal of its "following"; the magic has worn off the wand.

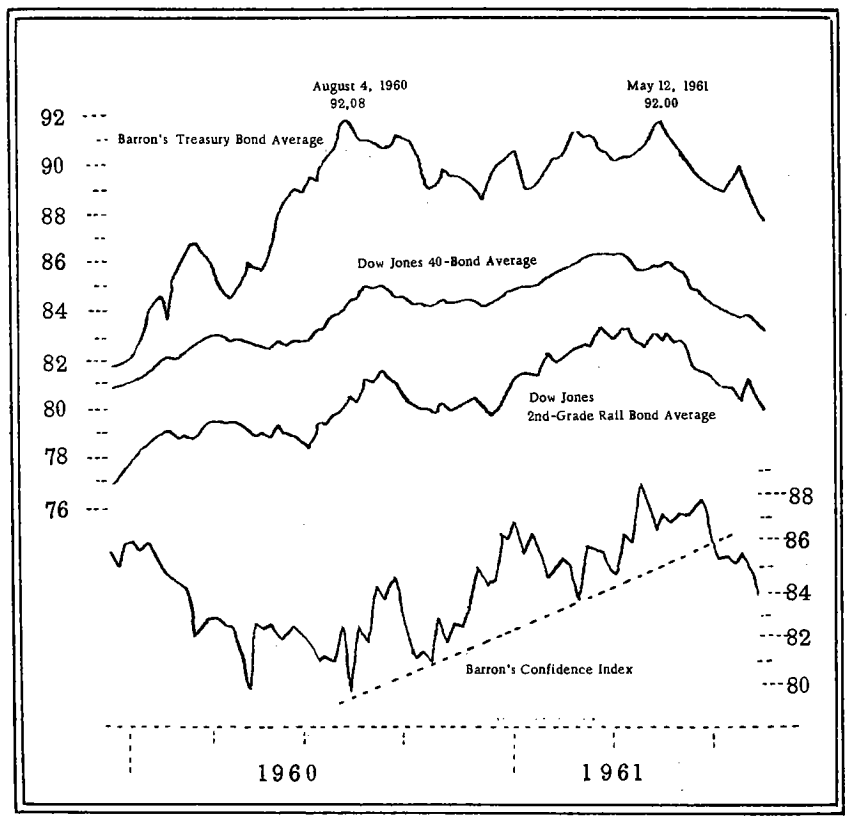
When a technical tool has been discredited, history suggests that it is usually on the way to working again. With this in

mind, I have been watching the progress of the C. I. over the last few months with more than the usual interest.

The theory behind the C. I. is simple enough. When bond buyers (a supposedly sophisticated group) turn bullish, they tend to foresake safety in favor of more attractive yields. Conversely, when bond buyers turn bearish, they tend to seek safety while foresaking yields. Barron's 10 Highest Grade Bonds represent a high degree of safety. The broad D-J 40 Bond Average represents a group which provide attractive yields. The C. I. is actually the ratio of the yield on Barron's 10 Highest Grade Bonds and the yield on the D-J 40 Bond Average. The C. I. rises when bond buyers turn bullish (when they move into the D-J 40 Bonds); the C. I. falls when bond buyers turn bearish (when they switch into Barron's 10 Highest Grade Bonds).

Since May, 1961 (see chart), another index, Barron's Treasury Bond Average, has been retreating. Letter 146 called attention to the amazing "double top" on this Average, and the opinion was expressed that the Federal Reserve's attempt to hold down interest rates ("Operation Nudge") was running into trouble. Since that time the Treasury Index has dropped to its lowest point since mid-1960. As of this writing, in fact 12 of the 32 listed Treasury bonds have dropped to the point where they now yield better than 4%.

Both the D-J 40 Bond Average and the highly speculative 2nd Grade Rail Bond Average (which is the volatile component of the 40 Bond Average) have been moving into lower territory since March, 1961. Moreover, the C. I. (which touched a peak of 88.5 on April 28, 1961) has turned down and broken a well established trendline (see chart). This is a trendline which has remained intact since mid-1960, and its penetration must be considered important.




Historically, trends on the C. I. precede stock market trends by two to four months. Because the C. I. touched its peak on April 28, the outward limit of its prediction (four months later) would be the end of August. If the C. I. is to retain its use as a forecasting tool, the market should see at least a temporary peak no later than August 28. Based on the pattern of the C. I., a market decline (following an August peak) could be substantial.

NOTES FROM THE PACIFIC The city of San Diego is a remarkable place. The sun always shines, the temperature never drops below 50 degrees, nobody buys anything with cash (even the dentistry is financed here), and the local printer can punch holes in my Letters without holding up delivery (which was not the case in the great city of New York). Everybody in Southern California is bullish (perhaps it's the effect of the weather), and real estate salesmen assure me that land values will double every five years ad infinitum.

Despite all this, the market continues to trace its emotionless pattern on my charts. The Averages remain the sum total of the optimism of California, the sophistication of New York, the shrewdness of Vermont and the coldness of Chicago.

I would like to take a paragraph to thank the many Californians who have called or dropped in to wish me well. To a New Yorker used to the impersonalness of the city, such neighborliness borders on the incredible. I would also like to thank the many subscribers who were kind enough to write words of encouragement regarding the Coast to Coast change. I will try to answer most of the letters over the next month.

STOCKS Seven of the stocks in our "continuing study group are now under their long-term or 30-week moving average (M. A.). This is two more than last week.

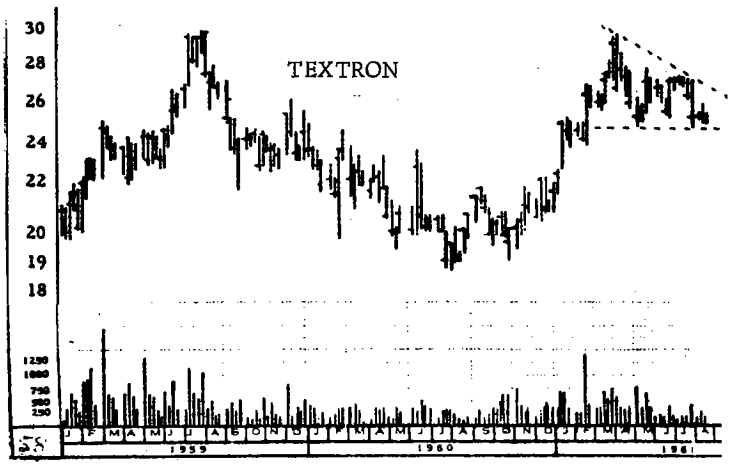
**DuPont** (M. A. 215) has been mentioned frequently as one of the stronger stocks in the Average. It was one of the leaders on the recent rally, and the stock remains in a bull trend.

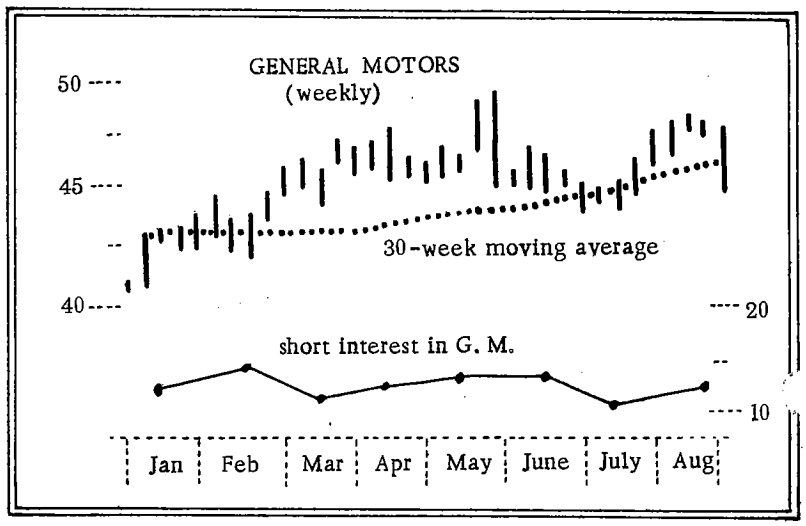
General Motors is beginning to appear "toppy" on the chart. It dropped below its M. A. of 46 last week, and its short interest is unimpressive. I list the stock as neutral--bearish if it closes at 42.

Letter 151 mentioned the four month increase in the short interest of International Paper. Whenever there is an increase of four or more months in the short interest of a stock it is worth watching. Over the last month IP rose to a new high for the year. The stock turned bullish when it bettered its M. A. of 33.

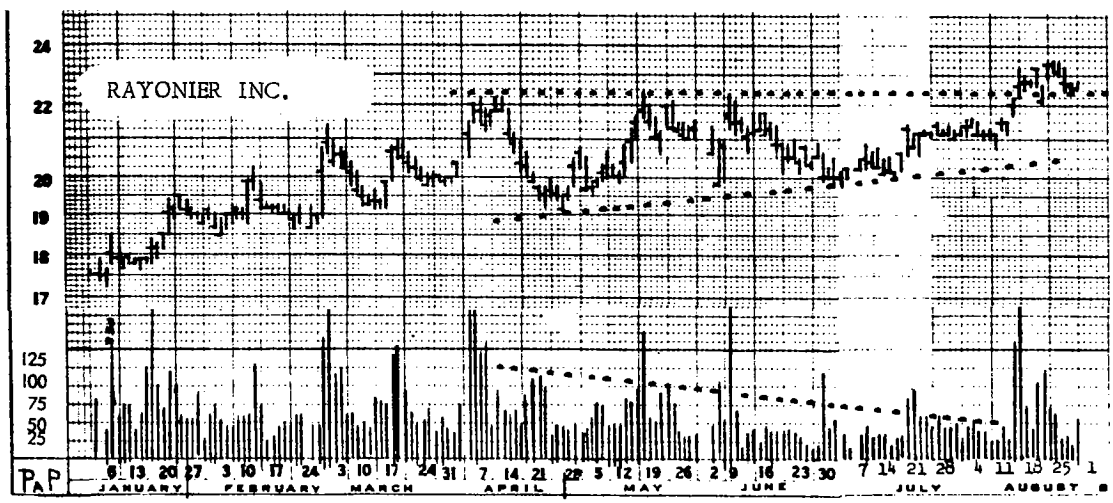
I have not like Standard of Jersey for many months. J is still under its M. A. of 45 3/4 and could break sharply if it closes in the 42 1/2 area.

Southern Pacific has been recommended repeatedly and recently rose to an all-time high. The stock remains bullish with an M. A. at 23 3/4.




I have included a daily chart showing the large ascending triangle in Rayonier Inc. Note the steady diminution of volume as the triangle progresses; this is a normal occurrence. The stock "broke out" when it bettered the top of the triangle at 22 1/2. It has now "pulled back" to the triangle top on lower volume. Such pull-backs are generally considered to be "buy-spots.




Textron (weekly chart shown) struck a "double top" of 29 1/2 in March of this year (previous top in the same area in 19591). Since then it has formed a bearish descending triangle. Textron is now a candidate for short selling on any rally. (Charts of Textron and Rayonier courtesy of Traders Research, P. O. Box 6185, Lambert Airport, Mo.)

Written Tuesday, August 29, 1961 at 12 P. M.